

July 28, 2011

**To:** Governor Sam Brownback

**From:** Kansas Division of the Budget

**Re:** Legislative Adjustments to Consensus Estimates for FY 2011 and FY 2012

Estimates for the State General Fund are developed using a consensus process that involves the Division of the Budget, the Kansas Legislative Research Department, the Department of Revenue, and three consulting economists, one each from the University of Kansas, Kansas State University, and Wichita State University. This estimate is the base from which the Governor and the Legislature build the budget. The Consensus Group met on April 15, 2011, to revise the FY 2011 and FY 2012 estimates, which were subsequently adjusted for legislative changes. This section presents the economic assumptions upon which the estimates are based. The next section covers the revenue projected by the consensus estimating process and the adjustments resulting from legislation that affects receipts. The section concludes with a table that adds the consensus numbers and the adjustments to produce a new total revenue estimate.

### Basic Economic Assumptions

The table below presents the key economic indicators used to estimate State General Fund revenues for FY 2011 and FY 2012. A great deal of uncertainty on the state's economy remains, as a number of economic indicators are estimated to show only modest improvements over the next few years. Significant concerns remain on the effect of higher oil prices and employment levels for many of the state's key sectors, including aviation manufacturing and telecommunications.

#### Key Economic Indicators

	2010	2011	2012
Consumer Price Index for All Urban Consumers	1.6 %	2.2 %	2.2 %
Real U.S. Gross Domestic Product	2.9	3.2	3.7
Nominal U.S. Gross Domestic Product	3.8	4.1	5.6
Nominal U.S. Personal Income	3.1	4.2	6.0
Corporate Profits before Taxes	37.0	4.0	10.0
Nominal Kansas Gross State Product	3.9	4.0	5.3
Nominal Kansas Personal Income:			
Dollars in Millions	\$113,375	\$117,986	\$124,357
<i>Percentage Change</i>	2.7 %	4.1 %	5.4 %
Nominal Kansas Disposable Income:			
Dollars in Millions	\$103,325	\$106,425	\$109,144
<i>Percentage Change</i>	2.9 %	3.0 %	2.6 %
Interest Rate for State General Fund (based on fiscal year)	0.96	0.47	0.27
Kansas Unemployment Rate	7.0	6.8	6.1

Estimates of nominal Kansas Gross State Product used in November of 4.1 percent for 2011 and 5.8 percent for 2012 have now been decreased to 4.0 percent and 5.3 percent, respectively. The Consensus estimates made in April were based on the continued modest recovery of the state's economy during the balance of FY 2011 and slightly accelerated growth throughout FY 2012.

**Federal Legislation.** Since the estimates were made last fall, one important new development relates to the federal enactment of the Tax Relief Act of 2010. Because Kansas generally begins computation of its income tax liability using federal tax law as a starting point, a number of provisions of the new federal tax law changes will flow through and also affect state income tax receipts. The new federal tax provisions will allow for 100.0 percent expensing of certain capital investments made through the end of calendar year 2011 and will allow for 50.0 percent bonus depreciation for certain capital investments made in tax year 2012, removes limitations on itemized deductions by high-income taxpayers, and extends the expansion of the Dependent Care Tax Credit and Earned Income Tax Credit that were set to expire in 2010. The new federal tax provisions are estimated to reduce individual and corporation income tax receipts for the two fiscal years by a total of \$77.0 million (\$24.0 million in FY 2011 and \$53.0 million in FY 2012). This fiscal effect accounts for only the reduction of individual and corporate income tax receipts as a result of the passage of the Tax Relief Act of 2010 and does not account for possible increases in revenue from other tax sources as a result of increased disposable income.

**Kansas Personal Income.** Kansas Personal Income (KPI) is currently expected to increase by 4.1 percent in 2011 and 5.4 percent in FY 2012. The new 2011 estimate improved slightly from the KPI forecasts used in November which showed KPI increasing by 3.4 percent, while the 2012 KPI estimate decreased slightly from the 5.6 percent shown in November. Current estimates are that overall US Personal Income (USPI) growth will fare moderately better than KPI, with nominal USPI estimates of 4.2 percent in 2011 and 6.0 percent in 2012.

**Employment.** Data obtained from the Kansas Department of Labor indicate that employment levels which had been relatively stable since the fall of 2009, declined over the winter months and may suggest that jobs were temporarily lost due to weather conditions, which would likely be short-term job losses that would be expected to return in future monthly data releases. Current estimates indicate that the overall Kansas unemployment rate, which was 7.0 percent in CY 2010, is expected to decrease to 6.8 percent in CY 2011 and 6.1 percent in CY 2012. The national unemployment rate is expected to remain above the Kansas rate, with the US rate now expected to be 9.4 percent in 2011 and 8.4 percent in 2012.

**Agriculture.** The outlook for net farm income continues to improve with relatively strong production levels, higher sustained commodity prices, and rising farmland values. The All Crops Index of Prices received by Kansas farmers was 245 in March, down 19 points from February, but up 88 points from 2010. The latest prospective plantings report indicates that farmers expect to plant 20.4 million acres of the four major grain crops in 2011, up 2.5 percent from 2010. If realized, the amount of acres planted with corn would be the largest since 1936 and the amount of acres planted with corn and soybeans would be greater than the amount of acres planted with wheat for the second year in a row. This would be the second lowest amount of acres planted with wheat since 1957 and the second highest amount of acres devoted to soybeans. Average livestock prices in mid-March were above prices from a year earlier.

**Oil & Gas.** The average price per taxable barrel of Kansas crude oil is now estimated to be \$77 in FY 2011 (up from the \$73 estimate used in November) and reflects the annualized effect of the recent increase in world prices since the November estimate. The estimated average price of \$82 per barrel for FY 2012 (up from \$75 in November) takes into account current oil futures price expectations that have been impacted significantly by recent political tension in several large oil producing countries. A great

deal of uncertainty remains about forecasting the price of this commodity; however, it appears that high prices will continue in the foreseeable future. Gross oil production in Kansas, which had steadily increased since FY 2005, fell slightly in FY 2010. The current forecasts of 40.0 million barrels for FY 2011 and 41.0 million barrels for FY 2012 will continue the pattern of steady growth in production and reflects the expectation that production levels will increase from the November estimate of 39.0 million barrels for both FY 2011 and FY 2012. It is estimated that 48.0 percent of all Kansas oil produced will not be subject to severance taxation because of various exemptions in state law.

The price of natural gas is expected to average \$3.85 per mcf for FY 2011 before increasing to \$4.15 per mcf for FY 2012, based on an industry source's analysis of futures markets. The new price estimates are slightly higher than the \$3.60 and \$3.95 estimates used in the fall. Factors considered in revising the price forecasts included the relationship between crude oil and gas prices, the current relatively high storage levels for gas, industrial demand, and the impact of enhanced production from shale formations elsewhere in the United States. Kansas natural gas production in FY 2010 of 347.6 million cubic feet represented a significant decrease from the modern era peak of 730.0 million cubic feet in FY 1996 (largely as a result of depleting reserves in the Hugoton Field). Production is estimated to continue to decrease in the future and is expected to be 320.0 million cubic feet in FY 2011 before decreasing to 300.0 million cubic feet in FY 2012. Approximately 10.0 percent of natural gas produced is expected to be exempt from severance taxation in both FY 2011 and FY 2012.

**Inflation.** The Consumer Price Index for all Urban consumers (CPI-U) increased by 1.6 percent in 2010, which is identical to the November forecast. The current forecasts of 2.2 percent for both 2011 and 2012 indicate that inflation will likely continue to be held in check by aggressive Federal Reserve monetary policy. The inflation expectations have changed slightly since the forecast reported in November, which showed that inflation would increase by 1.6 percent in 2011 and by 2.4 percent in 2012.

**Interest Rates.** The Pooled Money Investment Board is authorized to make investments in U.S. Treasury and agency securities; highly rated commercial paper and corporate bonds; as well as repurchase agreements and certificates of deposit of Kansas banks. Low idle fund balances compared to previous years require PMIB to maintain a highly liquid portfolio, which reduces the amount of return available to the pool. In FY 2010, the state earned 0.96 percent on its SGF portfolio (compared with a 2.20 percent rate in FY 2009). The average rate of return forecasted for FY 2011 is now 0.47 percent (down slightly from the 0.53 percent estimate used in November). For FY 2012, the forecasted rate is 0.27 percent (up slightly from the 0.24 percent rate assumed in November), but greater than expected cash balances are projected to bring in slightly more earnings to the State General Fund.

## Consensus Receipt Estimates

For the April revision, each revenue source was evaluated independently, taking into consideration the most recent economic indicators and tax collection information from the Department of Revenue, the Insurance Department, and year-to-date receipts. The consensus estimates are then adjusted to reflect legislation that was enacted after the April revision that has a fiscal effect on State General Fund receipts.

**FY 2011.** The revised FY 2011 estimate of State General Fund receipts is \$5.780 billion, which is a \$5.6 million decrease from the estimate made in November 2010. The revised estimate is \$588.3 million, or 11.3 percent, above actual FY 2010 receipts. This increase from the FY 2010 receipts can largely be attributed to the impact of the retail sales and compensating use tax increase enacted last year.

The estimate for total taxes was increased by \$2.1 million, while the estimate of other revenue was decreased by \$7.7 million. The estimate for corporation income taxes was decreased by \$29.0

million, which includes an estimated \$19.0 million from the state impact of the federal tax law changes that were made in December. The retail sales tax estimate was reduced by \$10.0 million. The estimate for agency earnings was reduced by \$7.3 million reflecting lower than expected district court fines, penalties, and fees. Other receipt estimates that were reduced by at least \$1.0 million include the cigarette tax (reduced by \$3.0 million), estate tax (reduced by \$2.5 million), net transfers (reduced by \$1.4 million), and the liquor enforcement tax (reduced by \$1.0 million).

On the positive side, the individual income tax estimate was increased by \$21.2 million based on stronger Kansas Personal Income (KPI) growth and the assumptions that modest employment growth will occur over the remainder of the fiscal year. However, the individual income tax estimate would have been \$5.0 million higher if not for the estimated state impact of the federal tax law changes that were made in December. The overall severance tax estimate was increased by \$10.1 million (\$7.2 million attributable to oil and \$2.9 million attributable to gas). The estimate for the insurance premiums tax was increased by \$8.0 million, from \$124.0 million to \$132.0 million, based on higher year-to-date receipts that were already ahead of the November estimate. Other revenue sources that were increased by at least \$1.0 million include the corporate franchise tax (increased by \$6.0 million), compensating use tax (increased by \$3.0 million), and SGF interest (increased by \$1.0 million).

The revised FY 2011 State General Fund estimate also includes the estimated fiscal effect of legislation that was enacted after the April revision. Senate Substitute for HB 2014, the omnibus appropriations bill, increased net transfers by a total of \$1,230,000. The bill requires an additional \$800,000 transfer to the State General Fund from the Investor Education Fund of the Office of the Securities Commissioner and a transfer to the State General Fund of \$500,000 from the fee funds of the Commission on Peace Officers Standards and Training, which is partially offset by a \$70,000 net reduction to various smaller transfers. The revised FY 2011 State General Fund estimate also includes the use of \$3.4 million in federal Temporary Assistance to Needy Families (TANF) for earned income tax credits. The Governor included this adjustment in his revised FY 2011 budget proposal; however, no specific legislation is required to make this adjustment to the amount of net receipts to individual income taxes in FY 2011.

**FY 2012.** Receipts for FY 2012 are now estimated to be \$6.046 billion, an increase of \$266.5 million, or 4.6 percent, when compared to the revised FY 2011 figure. Total taxes in FY 2012 are now projected to increase by \$227.5 million, or 4.1 percent, above the newly revised FY 2011 amount. Since the November 2010 estimate, total State General Fund receipts were increased by \$235.4 million, including an \$11.0 reduction in overall tax receipts and a \$246.4 million increase in other revenue.

The individual income tax estimate was increased by \$21.8 million based on the expectation of continued positive growth in KPI and modest employment growth. The individual income tax estimate would have been \$24.0 million higher if not for the estimated state impact of the federal tax law changes that were made in December. The overall severance tax estimate was increased by \$13.4 million (\$11.2 million attributable to oil and \$2.2 million attributable to gas). The insurance premiums tax (increased by \$8.0 million), compensating use tax (increased by \$5.6 million), and SGF interest (increased by \$1.2 million) were the only revenue sources to have their estimates increased by more than \$1.0 million.

The estimate for corporation income taxes was decreased by \$49.0 million, which includes an estimated \$29.0 million from the state impact of the federal tax law changes that were made in December. The retail sales tax estimate was reduced by \$4.7 million, tempered by the effects of sustained higher oil prices on consumer spending. Other receipt estimates that were reduced by at least \$1.0 million include agency earnings (reduced by \$7.4 million), cigarette tax (reduced by \$5.0 million), and the liquor enforcement tax (reduced by \$1.0 million).

The estimate for net transfers to the State General Fund was increased by \$252.6 million from the estimate made in November 2010. The gain from transfers in this year arose from the State General Fund receiving transfers of \$205.0 million from the State Highway Fund and \$34.0 million from the Expanded Lottery Act Revenues Fund. Transfers out of the State General Fund were also altered with the \$6.0 million transfer to the State Water Plan Fund that was suspended and a new transfer of \$6.7 million to the Children's Initiatives Fund to help with cashflow in that fund because of lower than previously estimated tobacco settlement revenue.

The FY 2012 estimates were also adjusted as a result of enacted legislation. House Substitute for SB 196 enacts a new state income tax deduction for expensing certain qualified investments and repeals several sales tax exemptions. These changes are estimated to increase revenues to the State General Fund by a net total of \$2,874,000 in FY 2012, including a \$5,324,000 increase in retail sales tax receipts, \$3,550,000 increase in the compensating use tax receipts, \$4.5 million reduction to corporation income tax receipts, and a reduction of \$1.5 million to individual income tax receipts.

SB 193 contained several tax provisions, requiring that social security numbers be provided in order to claim most state tax credits and to participate in the Food Sales Tax Rebate Program. The bill also expanded the Promoting Employment Across Kansas (PEAK) Program; established a formula for calculating property taxes due on certain land legally described in plats; makes several changes to the High Performance Incentive Program (HPIP) tax credit; and enacts a new sales tax exemption for game birds. The bill is estimated to increase State General Fund revenues by a total of \$1,840,000, including a \$2,350,000 increase in individual income tax receipts, which is offset by a \$450,000 decrease in corporation income tax receipts and a decrease of \$60,000 in retail sales tax receipts.

SB 61 expanded the Individual Development Account tax credit, which is estimated to reduce individual income tax receipts by \$32,000. SB 124 reduced agency earnings by \$75,000 as a result of diverting oil and gas royalty payments from five counties to the new Arkansas River Gaging Fund. SB 229 reduces the proportion of fee revenue that certain state agencies deposit in the State General Fund. This bill is expected to reduce agency earnings by \$1,723,549 in FY 2012. HB 2020 would require that any interest earnings from the Johnson County Education Research Triangle sales tax be transferred from the State General Fund to the Johnson County Education Research Triangle Fund. The interest earnings are estimated to be \$4,320 in FY 2012. The appropriations bill, 2011 Senate Substitute for HB 2014 increases SGF receipts by a total of \$254.0 million attributable to numerous changes in transfers.

Four additional pieces of legislation are expected to have an impact on FY 2012 receipts, but the amount cannot be quantified. House Substitute for SB 6 will divert certain driving under the influence fines from the State General Fund to other funds. House Substitute for SB 55 will eliminate fees, a portion of which under current law are distributed to the State General Fund, for persons filing for arrest expungement after criminal charges have been dismissed for certain reasons. SB 76 expands bingo gaming in a number of ways that will increase bingo tax receipts. SB 77 authorizes taxpayers to make withholding tax payments on certain unemployment insurance benefits which may provide a one-time acceleration of individual income tax receipts into FY 2012 depending on how widespread this provision is utilized.

## Summary Table

The following table summarizes all actual revenue to the State General Fund in FY 2010, as well as the agreed upon FY 2011 and FY 2012 estimates, including transfers, the various tax sources, interest, and agency earnings.

**Consensus Revenue Estimate**  
**As Adjusted for Legislation**  
*(Dollars in Thousands)*

	FY 2010 Actual		FY 2011 Approved		FY 2012 Approved	
	Amount	Percent Change	Amount	Percent Change	Amount	Percent Change
Property Tax:						
Motor Carrier	\$ 24,993	(14.6) %	\$ 25,500	2.0 %	\$ 27,000	5.9 %
Income Taxes:						
Individual	\$2,418,208	(9.8) %	\$2,598,398	7.5 %	\$2,726,818	4.9 %
Corporation	224,940	(6.4)	231,000	2.7	226,050	(2.1)
Financial Inst.	16,515	(36.9)	21,000	27.2	21,500	2.4
Total	\$2,659,663	(9.8) %	\$2,850,398	7.2 %	\$2,974,368	4.3 %
Estate Tax	\$ 8,396	(62.7) %	\$ 500	(94.0) %	\$ --	(100.0) %
Excise Taxes:						
Retail Sales	\$1,652,037	(2.2) %	\$1,990,000	20.5 %	\$2,085,264	4.8 %
Compensating Use	205,540	(12.5)	283,000	37.7	300,550	6.2
Cigarette	99,829	(6.9)	94,000	(5.8)	92,000	(2.1)
Tobacco Prod.	6,352	10.9	6,500	2.3	6,700	3.1
Cereal Malt Beverage	1,989	(4.8)	1,850	(7.0)	1,850	--
Liquor Gallonage	17,953	(1.4)	18,800	4.7	19,200	2.1
Liquor Enforcement	54,827	1.9	57,000	4.0	58,000	1.8
Liquor Drink	8,930	(2.3)	9,000	0.8	9,100	1.1
Corporate Franchise	41,462	(0.6)	24,000	(42.1)	8,000	(66.7)
Severance	81,870	(34.1)	102,900	25.7	107,700	4.7
Gas	39,988	(45.8)	41,600	4.0	41,600	--
Oil	41,882	(17.0)	61,300	46.4	66,100	7.8
Total	\$2,170,788	(5.1) %	\$2,587,050	19.2 %	\$2,688,364	3.9 %
Other Taxes:						
Insurance Prem.	\$ 120,375	0.7 %	\$ 132,000	9.7 %	\$ 133,000	0.8 %
Miscellaneous	1,655	(7.7)	1,800	8.8	2,000	11.1
Total	\$ 122,030	0.5 %	\$ 133,800	9.6 %	\$ 135,000	0.9 %
Total Taxes	\$4,985,870	(7.8) %	\$5,597,248	12.3 %	\$5,824,732	4.1 %
Other Revenues:						
Interest	\$ 24,629	(61.6) %	\$ 18,400	(25.3) %	\$ 12,996	(29.4) %
Net Transfers	127,410	274.1	114,930	(9.8)	158,900	38.3
Agency Earnings	53,365	(34.0)	49,000	(8.2)	49,401	0.8
Total Other Revenue	\$ 205,403	14.7 %	\$ 182,330	(11.2) %	\$ 221,297	21.4 %
Total Receipts	\$5,191,273	(7.1) %	\$5,779,578	11.3 %	\$6,046,029	4.6 %